

Internal Revenue Service

Department of the Treasury

PERSON TO CONTACT:

EMPLOYER IDENTIFICATION NUMBER:

CONTACT TELEPHONE NUMBER:

IN REPLY REFER TO:

DATE: FEB 28 2000

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

You were incorporated on [REDACTED], for the specific purpose of enhancing education and achievement in science and technology for educators, other professionals and the general public, through educational projects, programs and products, evaluation and support services, and publications.

Your proposed activities include the following:

- a) Developing and administering educational projects tailored to targeted audiences.
- b) Evaluating and assessing independent educational activities, projects and products in science, biotechnology and biomedicine.
- c) Facilitating educators in the grant process.
- d) Conducting educational tours of academic and industry research and development facilities for targeted audiences.
- e) Licensing educational products for educators.
- f) Producing, marketing and distributing educational materials.

Regarding your activity of developing and administering educational projects, you indicate you will evaluate and assess independent educational activities, projects and products for non-profit individuals and groups, including curricula, supplemental educational materials, education reports, student tests and evaluations, textbooks, software and multimedia materials. Fees will be charged on a criteria-based sliding scale, from below cost to market rate, depending on the nature of the requesting organization and the availability of funds. In most cases, fees will be significantly below market rates, with costs offset by donations, grants and the use of volunteers.

Regarding your activity of evaluating and assessing independent educational activities, projects and products in science, biotechnology and biomedicine, you indicate educational entities will contract (or subcontract) with your organization to perform formative and/or summative evaluations of such activities, projects or products. You will employ a variety of methods for such evaluations, including qualitative and quantitative assessments of targeted users. These activities will be conducted by your officers, or by an informal steering committee with oversight by your officers.



Regarding your activity of facilitating educators in the grant process, you indicate your organization will act as fiscal agent for individuals who have projects relating to science, technology and related educational subjects. Your organization will determine which projects are submitted through your organization, and you will provide reporting, accounting and project management consultation services, as well as networking among the program staff. You will also provide the usual employee benefits and periodic progress review for each project. There are no fees to educators to begin the grant process through your organization, although applicants are expected to cover actual costs during the grant development process. You anticipate requesting between [REDACTED] % (as permitted by the granting agency) of the total direct costs of the projects to provide the reporting and accounting services. The trademarks, copyrights, royalties, titles, and general ownership of products developed through the grant projects will be owned by the individual creators. By acting as fiscal agent, you will help facilitate the development of any type of product relating to science, technology and health education.

Regarding your activity of licensing educational products for educators, products will be presented to your organization through a no-fee application process. Products may be either from [REDACTED]-sponsored projects, or unrelated products developed on the outside. Upon acceptance by your officers (or designated committee), you will survey educational outlets (publishers, vendors,...) that may have an interest in the product to be licensed. You will make contact with prospective licensee businesses, draft license agreements for review by both parties, and finalize the licensing. Your organization will monitor the license agreement over the period of the agreement and report to the client on progress. Products will be licensed in the name of the creator or copyright holder. Fees charged for the licensing services will be on a criteria-based sliding scale, from below cost to market rate. You will raise grant support to provide assessment services below cost. The sliding scale is anticipated to range between [REDACTED] and [REDACTED] %, which in most cases will be below cost.

Regarding your activity of producing, marketing and distributing educational materials, you state you will produce and/or market educational products about [REDACTED], [REDACTED], and [REDACTED] for targeted audiences. These educational products will include items such as curriculum materials, multimedia instructional aids, laboratory manuals and kits, computer software, books and pamphlets. Sales price will be determined based on the cost of developing and producing the product, as well as a survey of the sales price of similar products in the market place. From revenues generated, you will receive (1) reimbursement for any out-of-pocket marketing expenses, (2) reimbursement for any out-of-pocket production costs (if you produce the item, rather than receiving the inventory from the creator), and (3) a small fee expressed as a percentage of the sales price to cover staff time and overhead costs. The fee may be adjusted on a criteria-based sliding scale. Remaining revenues will be passed on to the copyright holder. Products will be marketed to the general public.

You also indicate you will sell educational materials for creators through listings and sales from your web site, as well as direct mailings. The purchase price will be determined by the creator in consultation with you as part of the application process. The purchase price will include cost of production or duplication, royalties to the creator, and fees to your organization. The fee will be adjusted on a criteria-based sliding scale. If duplicate items are submitted to you for sale, you indicate you will charge a commission of up to [REDACTED] % of the sale price, with the rest returned to the creator. If you need to duplicate the product, you may charge the creator actual duplication costs and [REDACTED] percent to be paid in advance, as well as retaining the negotiated commission. You will not distribute items sold through for-profit outlets.

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations which are organized and operated exclusively for charitable, religious, and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations specifies that an organization is organized for one or more exempt purposes, if its Articles of Incorporation limit the purposes of such organization to exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not organized or operated for any purpose under section 501(c)(3), unless it serves a public rather than a private interest. Thus to meet the requirements of this subparagraph, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization or persons controlled, directly or indirectly, by such private interests. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes, if more than an insubstantial part of its activities serve private interests.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operations of such trade or business are in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of activities, which are in furtherance of one or more exempt purposes.

While you are organized on a nonprofit basis, nonprofit is not the same as exempt. The fact that you do not make a profit is not the controlling factor. See United States v. La Societe Francaise de Bien, Mut., 152 F. 2d 243 (9th Cir. 1945), cert. denied 327 U.S. 793 (1946); Hassett v. Associated Hospital Service Corporation, 125 F. 2d 611 (1st Cir. 1942), cert. denied 316 U.S. 672 (1942); Baltimore Health and Welfare Fund v. Commissioner, 69 T. C. 554 (1978); and B. S. W. Group, Inc. v. Commissioner 352 (1978).

Section 502 of the Internal Revenue Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be tax exempt on the grounds that all of its profits are payable to exempt organizations.



Letter Business Bureau v. United States, 326 U.S. 279-283, (1945), the court held that the existence of a single non-exempt purpose, if substantial in nature, would destroy exemption under section 501(c)(3) regardless of the number or importance of truly exempt purposes. To qualify for exemption under section 501(c)(3), the applicant organization must show (1) that it is organized and operated exclusively for religious or charitable purposes, (2) that no part of the net earnings inures to the benefit of a private individual or shareholder, and (3) that no substantial part of its activities consists of the dissemination of propaganda or otherwise attempting to influence legislation or engaging in political activity. See Kenner v. Commissioner, 318 F. 2d. 632, (7th Cir. 1963).

In general, an organization that applies for recognition of exemption has the burden of proving that it clearly meets all the requirements of the particular Code section under which it has applied. See Kenner v. Commissioner, 318 F. 2d 632 (7th Cir. 1963), and Cleveland Chiropractic College v. Commissioner, 312 F. 2d 203, 206, (8th Cir. 1963)

Revenue Ruling 71-395, published in Cumulative Bulletin 1971-2, on page 228, describes a cooperative art gallery formed and operated by a group of member artists for the purpose of exhibiting and selling the members' works of art. The gallery was open six days of the week and a sales commission was retained that is both real and, taking the organization's circumstances and financial resources into account, substantial. Therefore, an organization that raises funds for charitable purposes but consistently uses virtually all its income for administrative and promotional expenses with little or no distribution to charity cannot reasonably argue that its distributions are commensurate with its financial resources and capabilities.

Revenue Ruling 66-104, published in Cumulative Bulletin 1966-1, on page 135, describes a nonprofit organization which makes funds available to authors and editors for preparing teaching materials and writing textbooks, and, under the terms of the contract with the publisher, receives royalties from sales of the published materials and then shares them with those individuals, does not qualify for exemption under section 501(c)(3). It was held that although educational interests are served by the publication of better teaching materials, the facts in the case show only an enterprise conducted in an essentially commercial manner, in which all participants expect to receive a monetary return.

Revenue Ruling 72-369, published in Cumulative Bulletin 1972-2, on page 245, describes an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations. It held that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable within section 501(c)(3) of the Code. Furnishing of services at cost lacks the donative element necessary to establish the activity as charitable.

In Revenue Ruling 67-4, published in Cumulative Bulletin 1977-1, on page 121, the Service recognized four criteria indicating that publishing activities are directed to the attainment of purposes specified in section 501(c)(3). These criteria are: (1) The content of the publication must be "educational"; (2) The preparation of materials must follow methods generally accepted as "educational" in character; (3) The distribution of the materials must be necessary or valuable in achieving the organization's exempt purposes; and (4) The manner in which distribution is accomplished must be distinguishable from ordinary commercial publishing practices.

In analyzing the factors which distinguish whether an organization's activities are "sufficiently distinguishable from ordinary commercial practices" to qualify as carrying out an exempt purpose, the following factors are considered:



- (1) The only activity of the organization is publishing with the organization using standard commercial techniques to generate profits.
- (2) The publications are priced "competitively" with other commercial concerns or to return a profit.
- (3) Conducting an enterprise in a manner in which all participants expect to receive a profit.
- (4) Publishing materials almost exclusively for sale with only a de minimis amount of materials donated to charity.

Revenue Ruling 77-4 published in Cumulative Bulletin 1977-1, on page 141, provides an example of an ordinary commercial publishing operation. A non-profit corporation published a weekly newspaper, which contained local, national and world news, editorials and paid advertising. The newspaper's editorial content focused on matters of interest to a particular ethnic group. The organization never realized a profit from its operations. The organization was supported by advertising and sales of subscriptions. The religious matter qualify for exemption under section 501(c)(3) since it is advancing religion by disseminating information and not serving a commercial purpose.

In Scripture Press Foundation v. United States, 61-1, USTC 9195, the court was asked to consider whether the activities of a certain publishing company were primarily educational and charitable rather than business activities with a commercial purpose. The organization sold its publications at a price above their actual cost, or at a price that included a markup which established a profit. The court indicated in this case that the existence of profits gives some evidence that a business purpose rather than an educational purpose is primary.

In B.S.W. Group v. Commissioner, 70 T.C. 532 359 (1978), the court held that an organization that provided management and consulting services to nonprofit organizations at fees set to cover costs and yield a 10.8 percent profit was not organized and operated exclusively for charitable and educational purposes. Furnishing the services at cost or above cost lacked the donative element to be considered charitable. The court also stated that the presence of substantial profits constitutes evidence that an organization is operating for a commercial rather than exclusively educational purpose.

The court further stated that it thus becomes necessary to determine the correctness of the educational characterization of the organization's operations, since it is apparent that an important if not primary purpose of the organization is to promote a profitable business purpose. The court also stated that the substantial sales activities of this organization reflect a purpose.

Whether a purpose is educational has been interpreted by the courts to be more than conveying information or providing instruction. The purpose must provide instruction or training, which is intended to enable the individual to improve and develop his capabilities or to instruct the public on subjects useful to the individual and beneficial to the community.

Regulations 1.501(c)(3)-1(c)(1) indicates that an organization will not be exempt under section 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, an organization whose operations result in private benefit that is more than insubstantial, will not be considered as serving an exempt purpose. This private benefit prohibition applies to all kinds of persons and groups, not just to "insiders" subject to the more strict inurement proscription.

[REDACTED]

Your activities of evaluating and assessing independent educational activities, projects and products is a trade or business normally carried on for profit. You charge fees on a criteria-based sliding scale, ranging from below cost (offset by donations, grants and the use of volunteers) to market rate. You do not limit this activity to organizations that are exempt under section 501(c)(3) of the Code. The provision of the services is similar to the organization cited in Revenue Ruling 72-369, in that the provision of services at cost lacks the donative element necessary to establish the activity as charitable. Unlike the organization cited in Revenue Ruling 72-369, you do not limit your services to organizations that are exempt under section 501(c)(3) of the Code and you do not limit your fees to your cost. Neither of these differences reflects favorably on your organization. We have determined that this activity is neither charitable or educational as considered under section 501(c)(3) of the Code.

Your activity of facilitating educators in the grant process is a trade or business regularly carried on for profit. You determine which projects are submitted through your organization, and act as the fiscal agent for the individuals making the submissions. You provide reporting, accounting and management consultation services, networking opportunities among the program staff, employee benefits and periodic progress reviews. Although you do not charge a fee for individuals to begin the grant process, applicants are expected to cover their actual costs. You anticipate requesting [REDACTED] of the total direct costs (as permitted by the granting agency) to provide your services. Ownership of trademarks, copyrights, royalties, titles, and ownership of products remains with the individual creator. The provision of these services is also similar to that of the organization that was denied in Revenue Ruling 72-369, which found that furnishing of services at cost lacks the donative element to be considered charitable. While you do not limit your services to organizations that are exempt under section 501(c)(3), this difference does not further any exempt purposes. Additionally, the fact you anticipate requesting [REDACTED] of total direct costs indicates there is no provision for the limiting of your fees to actual costs. Due to this, your organization may also be compared to the organization cited in the B.S.W. Group v. Commissioner ruling. Therefore, we have determined that this activity is not charitable or educational within the meaning of section 501(c)(3) of the Code.

Your activity of licensing educational products for educators is a trade or business normally carried on for profit. Surveying and contacting prospective licensee businesses, drafting licensing agreements, finalizing the license agreements, and monitoring them are a normal part of business. You indicate a sliding scale, ranging between [REDACTED] and [REDACTED]%, will be used. By utilizing a sliding scale, you anticipate most of the fees for these services will be below cost. This activity is similar to that of the organization that was denied in Revenue Ruling 72-369, in that both organizations are providing services normally carried on for profit. Unlike that organization, you do not limit your services to charitable organizations. While indicating "most" of your clients will pay below cost, this implies that some will still pay cost or above. Therefore, we have determined that this activity is not exclusively charitable or educational within the meaning of section 501(c)(3) of the Code.

Your activity of producing, marketing and distributing educational materials is a trade or business normally carried on for profit. Your sales price will be determined based on the cost of developing and producing the product, as well as the sales price of similar products in the marketplace. Your organization will receive reimbursement for out-of-pocket expenses, as well as a small fee expressed as a percentage of sales price to cover staff time and overhead costs. Remaining revenues will be passed on to the copyright holders. Sales will be made to the general public. Your organization is similar to the organization described in Revenue Ruling 66-104, in that both organizations produced education-related products in a commercial manner. Although educational interests may be served by the production of these products, they are being produced and marketed in an essentially commercial manner, in which all of the participants expect to receive a



monetary return. Therefore, we have determined that this activity is not charitable or educational within the meaning of section 501(c)(3) of the Code.

Your activity of selling educational materials for creators through listings and sales on your web site, as well as direct mailings, is a trade or business normally carried on for profit. The purchase price is determined by the creator, in consultation with your organization. You will charge a commission of 10%, as well as additional charges if duplication is necessary. Your organization is similar to the organization described in Revenue Ruling 66-104, in that both organizations receive income from the commercial sale of publications or products, and then pass on a share to the creator. Your organization is similar to the organization described in Revenue Ruling 71-395, in that both organizations sell items for their creators, and retain a commission. The presence of profit also makes your organization comparable to the organization cited in the Scripture Press Foundation v. United States court ruling. Therefore, we have determined that this activity is not charitable or educational within the meaning of section 501(c)(3) of the Code.

Therefore, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate State officials.

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If someone who is not one of your principal officers will represent you, that person will need to file a power of attorney or tax information authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

[REDACTED]

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If you have any questions, please contact the person whose name and telephone phone number are shown in the heading of this letter.

Sincerely,

*Steven T. Miller*

Steven T. Miller  
Director, Exempt Organizations

Enclosure: Publication 892

cc: [REDACTED]